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No. 671

IN THE

Supreme Court of the United States

October Term 1958

A. D. JUILLIARD & CO., INC., *Petitioner,*

v.

JAMES W. JOHNSON, Collector of Internal Revenue for the Third District of New York, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment herein of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The majority and dissenting opinions of the Court of Appeals, printed in the Appendix hereto (App. 1a), are reported at 259 F.2d 837 (C.A. 2d 1958). The opinion of the District Court is reported at 166 F. Supp. 577 (S.D. N.Y. 1957). The District Court's Findings of Fact and Conclusions of Law, together

with the District Court's opinion, are printed in the Appendix to Appellant's Brief before the Court of Appeals, nine copies of which have been filed with this petition.

JURISDICTION

The judgment of the Court of Appeals was entered September 29, 1958. (App. 17a). Rehearing was denied October 31, 1958, with one Judge dissenting (App. 18a). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTION PRESENTED

Does the deductibility for income tax purposes of a payment to the United States on account of a violation of the Emergency Price Control Act depend on whether such a deduction would frustrate the clearly defined purpose of the Act, or does it depend on whether the taxpayer has a present right to set aside the compromise settlement and recover the payment from the United States?

STATUTE INVOLVED

Internal Revenue Code of 1939:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; . . . ."

STATEMENT

In this case, the Court of Appeals for the Second Circuit, which for many years has played a major role in the interpretation of the Internal Revenue Code, has established a novel rule that

(1) is in conflict with the recent decision of this court in *Tank Truck Rentals, Inc.* v. *Commissioner,* 356 U. S. 30 (1958);

(2) will discourage compromises of litigation with the Federal Government;

(3) is in conflict with decisions of the First Circuit in *Commissioner* v. *Pacific Mills,* 207 F.2d 177 (C.A. 1st 1953) and of the Court of Claims in *Lustig* v. *United States,* 138 F. Supp. 870 (1956); and

(4) establishes a different rule for determining deductibility of penalties as business expenses for federal income tax purposes, where the penalties are paid to the Federal Government as distinguished from the governments of the States.

The pertinent facts are as follows:* In 1942 petitioner, a manufacturer of woolen and worsted textile fabrics, was the defendant in the first suit brought by the Price Administrator seeking treble damages and injunctive relief on account of overcharges alleged to be in violation of the Emergency Price Control Act (R. 17a, 144a). Counsel for the Government and petitioner tentatively agreed upon a formula for computing damages for the alleged overcharges in settlement of the

*Page references in this Statement are designated "R." and refer to the Appendix to Appellant's Brief before the Court of Appeals, nine copies of which have been filed with this Petition.

litigation (R. 19a). Before the settlement payment was made, petitioner discovered and reported to the Government that it had made a mathematical error in computing a ceiling price on a fabric not previously included in the settlement, hereafter referred to as fabric A-2391 (R. 19a). As a result, overcharges of $110,098.30 on fabric A-2391 were specifically added to the settlement under the formula previously agreed upon (R. 19a). In 1943 petitioner paid $410,219.31 in settlement of the litigation, of which $330,294.90 represented damages of treble the $110,098.30 overcharge on fabric A-2391 (R. 19a).

After the settlement, petitioner and the Government agreed that the petitioner's ceiling price for fabric A-2391 was higher by 15 cents per yard than the one used in the settlement, and petitioner was authorized to use the higher price in all further sales (R. 26a, 27a). Had this error been discovered prior to settlement of the treble damage action, the overcharges on A-2391 would have been $66,023.76 instead of $110,098.30, and the treble damages paid by petitioner under the settlement would have been $132,223.62 less (R. 27a).

Petitioner deducted the entire $410,219.31 as a business expense under Section 23(1)(a)(1)(A) of the Internal Revenue Code of 1939 in its federal income and excess profits tax returns for 1943; the Commissioner disallowed the deduction, and petitioner brought this suit for refund (R. 4a).

In the District Court petitioner maintained that the entire $410,219.31 was deductible under *Commissioner* v. *Pacific Mills*, 207 F.2d 177 (C.A. 1st, 1953) and *Jerry Rossman Corp.* v. *Commissioner*, 175 F.2d 711 (C.A. 2d 1949) because the overcharges were neither wilful nor due to its failure to take practicable precau-

tions to observe maximum prices. The District Court found that petitioner did not take all practicable precautions, the Court of Appeals affirmed, and petitioner does not seek a review of that factual issue by this Court.[1]

In the District Court petitioner had also maintained that it was at least entitled to deduct the $132,223.62 which was included in the settlement through mutual mistake as to the proper ceiling price of fabric A-2391. The District Court held, however, that the out-of-court settlement took on the character of a judgment because it was referred to in the judgment granting the Government's prayer for injunctive relief and that petitioner could not "collaterally attack" that judgment in this suit for refund (R. 43a-52a). The Court of Appeals agreed with petitioner that the settlement was not part of any judgment but held, nevertheless, that the petitioner was not entitled to a tax deduction of the $132,223.62.

The basis of the Court's holding of primary interest here is the novel legal proposition that an inquiry into the computation of the settlement to find out what any part of the damages had been paid for would constitute a "reopening" of the settlement. The Court held that this would be improper in a tax refund case since it would result in a taxpayer recovering from the Government indirectly money which he could not recover directly by having the settlement set aside. Judge Hincks dissented from this holding on the ground that, under *Tank Truck Rentals, Inc.* v. *Commissioner*, *supra*, the right to deduct the payment depended solely on

[1] A directly opposite result in a similar and certainly no stronger factual situation has recently been reached in the Court of Claims, *Milton S. Kronheim & Co.* v. *United States*, 163 F. Supp. 620 (1958).

whether the deduction would frustrate any sharply defined statutory policy, a test which clearly permits the deduction on these facts.

The Court below also held that the payment to OPA was a lump sum payment, no part of which could be attributed to any specific violation. But this assertion is unsupported in the record and is in direct conflict with the undisputed facts and the findings of the trial judge, never questioned by the Court of Appeals. Judge Hincks in his dissent quickly and properly disposed of this aspect of the case.[2]

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[2] "Judge Leibell's careful and complete findings establish clearly that in the negotiations which followed the filing of the OPA complaint a settlement formula had been tentatively agreed upon which took no account of overcharges on Juilliard's fabric No. A-2391; and that thereafter errors were discovered by Juilliard employees in the Juilliard report on its fabric No. A-2391 which were promptly reported to OPA. The resulting overcharges in No. A-2391 amounted to about $110,000 which OPA insisted be trebled and added to the tentative settlement. This item brought the total amount of the settlement up to $410,219.31. Thus the amount paid by Juilliard for the settlement clearly included the trebled overcharges on fabric A-2391 as Judge Leibell repeatedly stated in his opinion.

"Three months after the settlement had been completed, the appellant reported to OPA a revised basis for the computation of a higher maximum price on A-2391. This was based largely on fabric No. A-2313 which later was found by OPA to be a proper base period fabric to which A-2391 was similar. As a result, OPA allowed a ceiling price of $2.975 per yard for A-2391. Although the fact-basis for this higher ceiling had been in existence and available at and prior to the settlement with OPA, it was not advanced by the appellant nor given effect by OPA until after the settlement. If the overcharge on A-2391 had been computed on the basis of this higher (by 15¢ per yard) ceiling which was subsequently allowed, the amount of the overcharges on A-2391 would have been $44,074.54 less and the trebled damages would have been $132,223.62 less, than the amounts included in the settlement." 259 F.2d at 844-845.

Petitioner filed a petition for rehearing directed solely to the question of the deductibility of the $132,223.62 mistakenly paid at settlement. The petition for rehearing was denied, Judge Hincks again dissenting (App. 18a). It is the holding of the Court of Appeals that this sum is not deductible which petitioner requests this Court to review.

REASONS FOR GRANTING THE WRIT

At the outset, it is important to ascertain as precisely as possible the holding of the majority of the Court of Appeals. It had been established at trial that a part of the payment made to the Government grew out of a mistake as to the ceiling price of a fabric rather than out of a violation of the regulations. It was, and is petitioner's position: (1) that under Section 23(a)(1)(A) of the Internal Revenue Code of 1939 (now Section 162(a) of the Internal Revenue Code of 1954) petitioner has the right to deduct ordinary and necessary business expenses; (2) that under the decisions of this Court, deduction is always permitted unless it would frustrate some statutory objective, a test which can be applied only by ascertaining the purpose for which the payment was made, and (3) that, accordingly, it is always proper, indeed necessary, to ascertain what a payment was made for in order to determine whether the payment is deductible.

The Court of Appeals, however, held that an inquiry into the character of any part of this payment was improper if the inquiry could result in a tax deduction. It took the view that the petitioner agreed that a certain sum of money was owing to the Government, that the Government settled the case on the theory that it

would receive that sum and would keep it. Now, according to the Court of Appeals, the petitioner may not claim a tax deduction on the theory that the settlement was at the wrong figure. The petitioner could not recover from the Government directly on this theory of mistake, the Court of Appeals holds, so petitioner cannot recover the payment indirectly by means of a tax deduction.

This Court of Appeals ruling that some principle of contract law prevents the court from ascertaining the facts on which deductibility for tax purposes depends is clearly in error. Furthermore, as will appear from what follows, this rule injects confusion in an area of law which this Court has but recently seen fit to clarify, is in conflict with the decisions of this and other courts, and may well have a highly undesirable effect on the ability of the Government to terminate litigation by out-of-court compromise.

1. The decision is in conflict with Tank Truck Rentals Inc. v. Commissioner.

The Court of Appeals decision is in conflict, at least in principle, with the decision of this Court in *Tank Truck Rentals, Inc.* v. *Commissioner,* 356 U. S. 30 (1958), and the related cases decided at the same time: *Hoover Motor Express Co.* v. *United States,* 356 U. S. 38 (1958), and *Commissioner* v. *Sullivan,* 356 U. S. 27 (1958). These cases established that the deduction of a business expense is permitted by the Internal Revenue Code in accordance with the clear intent of Congress to tax only net income, *except* where allowance of the deduction would frustrate sharply defined national or state policies. In applying this general rule to determine deductibility of "penal-

ties," the Court specifically approved the holding in *Jerry Rossman Corp.* v. *Commissioner*, 175 F.2d 711, 713 (C.A. 2d 1949), that some penalties are deductible and some are not, and that each case must turn on its own facts. This Court then said that "the test of non-deductibility always is the severity and immediacy of the frustration resulting from allowance of the deduction." 356 U. S. at 35. And, of course, the frustration referred to concerned the objective and purposes of the statute under which the penalty was imposed.

The decision below ignores this test and applies a new and different rule for cases where the payment is made under an out-of-court settlement with the United States. In such cases the decision below proscribes any effort to go behind the face amount of the settlement to ascertain the nature of a payment where doing so might result in a tax deduction, because of a policy against "disruption of settled rights." The Court holds in effect that a deduction is allowable only if the payment itself could be recovered from the Government under contract principles.

Frustration of any national policy is out of the question where a payment sought to be deducted was made and collected under a misapprehension as to liability. Even where a statutory violation has clearly occurred, the objectives of the Emergency Price Control Act have left room for differentiation between wilful or negligent and inadvertent violations in determining deductibility for income tax purposes. *Jerry Rossman Corp., supra* and *Commissioner* v. *Pacific Mills, supra.* Certainly, then, under the test prescribed in *Tank Truck Rentals, Inc.*, the objectives of the statute cannot in any sense prevent deduction of a payment to the

extent that the taxpayer can show the statute was not even violated.[3]

2. The decision below discourages the compromise of claims asserted by the Federal Government.

Federal statutes under which Government claims are compromised every day cover a wide field. To name a few, such statutes include the Sherman Anti-Trust Act, the Robinson-Patman Act, the Food and Drug Acts, the Fair Labor Standards Act, the Safety Appliance Acts, the postal laws, and many others. Compromises of claims under these statutes result from many influences, such as uncertainty respecting liability, dislike of publicity, and the financial condition of the defendant. But while there are many such factors involved, there can be no doubt that income tax considerations

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[3] Judge Hincks' statement on this point in terms of facts of the present case would seem to be unanswerable:

"I fully agree with my brothers that the appellant, having entered into a settlement with OPA, may not now recover back any part of the amount paid. But that is not to say that it is not entitled to a tax deduction. The allowability of a tax deduction as a business expense of damages paid to OPA depends upon whether the overcharges were made inadvertently or under such circumstances that the allowance of a deduction therefor would not frustrate any sharply defined statutory policy. *Jerry Rossman Corp.* v. *Commissioner*, 2 Cir., 175 F. 2d 711, distinguished but not disapproved in *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U.S. 30.

"In the circumstances of this case, the OPA's subsequent approval of the higher ceiling upon a basis which had existed before the settlement, serves as an authentic demonstration that the overcharges computed on the basis of the higher ceiling would have satisfied the statutory objectives. Consequently, the payments to the extent that they were based on the lower ceiling exceeded what was required to satisfy the statutory objective and a tax deduction in the amount of such excess ($132,223.62) would not frustrate national policy." 259 F.2d at 845.

affect the great majority of all settlements. In suits brought by the Government, the decision below restricts the effect of this one factor, common to most settlement processes, by casting doubt upon the right of the paying party to explain, for income tax purposes, the nature and purpose of the payment made.[4]

After this Court held in *Commissioner* v. *Heininger*, 320 U. S. 467 (1943), that legal expenses of contesting a Post Office fraud order were deductible, the Court of Appeals for the Second Circuit extended the rule there announced to cover deduction of a penalty under the Emergency Price Control Act, reasoning in part that limiting deduction to legal expenses would put a premium upon resistance. *Jerry Rossman Corp.* v. *Commissioner, supra*, 175 F.2d at 713. Yet that Court's decision in this case will have precisely the effect it there sought to avoid. The Court has ignored both the clear policy of the income tax statute to tax net income only and the obvious desirability of encouraging compromises of litigation; and it has done this in order to support the purely theoretical proposition that a tax deduction reduces indirectly the consideration received by the Government in an out-of-court settlement.

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[4] Petitioner would have had a clear right to go behind a judgment of a court awarding the damages paid here, on these facts, to show that the payment was not in fact based on a violation of the regulation. Proof of the error in the tax litigation would raise no problem of *res judicata* because a different cause of action would be involved. *Commissioner* v. *Sunnen*, 333 U. S. 591, 597 (1948). No problem of collateral estoppel would be presented because the specific issue of the overcharge on this item would not have been controverted or litigated in the OPA proceeding. *Commissioner* v. *Sunnen, supra*, 333 U. S. at 599. All of this is clearly recognized by the Court of Appeals. 259 F.2d at 844.

3. The decision is in conflict with decisions of the First Circuit and the Court of Claims.

Insofar as it denies petitioner the right "to dissect" or "to reopen" the compromise for the purpose of establishing a tax deduction the decision below is in conflict with the decisions of the Court of Claims in *Lustig* v. *United States*, 138 F. Supp. 870 (1956), and the Court of Appeals for the First Circuit in *Commissioner* v. *Pacific Mills*, *supra*. Both of these decisions allowed the taxpayer to dissect a settlement in order to establish the tax deductibility of a payment in compromise. In the *Lustig* case, Lustig and several corporations he controlled compromised admitted liabilities for taxes, penalties and interest of approximately $838,000 and $2,654,000, respectively, a total of $3,492,000, for a lump sum payment of $3,200,000. The compromise was effected by a statutory closing agreement. Prior to the settlement, the interest due on Lustig's individual liability was $67,500, and he deducted this amount of interest in computing his individual taxes for the year the lump sum settlement was paid. The Commissioner disallowed the deduction on the ground that the settlement payment was a lump sum payment in lieu of taxes, penalties and interest and that no allocation of interest could be made.[5] The Court of Claims recognized that the settlement payment was made in compromise of a larger liability, but held that if the amount of the interest included "is ascertainable from the agreement or the circumstances surrounding

[5] The Government has no hesitancy in claiming the right to reopen a settlement and to tax part of a payment it has made as being in fact interest or rent income, even though the collection of the tax reduces the taxpayer's net realization from the settlement. See for instance *Estate of Jacob Restor*, 17 T.C. 1085 (1952).

the agreement, we see no reason for denying a deduction for the interest." 138 F. Supp. at 873. The fact that such a deduction might reduce the Government's net realization from the settlement was irrelevant. The conflict between this ruling and the viewpoint of the majority of the Court of Appeals in this case is complete. The Court below said:

> "We can see no distinction between seeking to reopen in this suit the compromised question of the amount of appellant's liability for the purpose of a tax deduction and seeking to reopen it for the purpose of directly recouping money paid in settlement, which appellant concedes it may not accomplish." 259 F.2d at 844.

In *Pacific Mills*, a liability for treble damages under the Emergency Price Control Act was asserted against Pacific by the Government. It was compromised by agreement of Pacific to pay $2,065,842.02, which was not treble damages, but was some $250,000 in excess of single damages. The Government and Pacific appeared in District Court, filed a complaint, an answer, a stipulation for judgment granting injunctive relief and a judgment. The payment was made and the judgment signed in court, although the issues were not discussed or controverted. When the Commissioner disallowed a deduction of the $2,065,842.02 as a business expense, Pacific appealed to the Tax Court. Over the Government's objections, Pacific was allowed to show, and the Tax Court found, that the $250,000 excess over single damages paid as part of the settlement was not a penalty, but a sum calculated to cover overcharges for a period prior to the period covered by the terms of the settlement.

In both of these cases the taxpayer was permitted to go behind a compromise to prove the character of a portion of the payment made, in order to establish deductibility, even though the deduction reduced the Government's net realization from the settlement. Denial of petitioner's corresponding right to prove deductibility of a part of its payment cannot be rested on the difference that petitioner sought to prove that the amount paid was not due. This is pure rhetoric, for petitioner did not offer such proof to disturb the compromise payment itself any more than did Lustig or Pacific Mills. It sought only to establish the character of the payment so that its deductibility could be determined.

4. The decision discriminates against taxpayers who have compromised claims with the Federal Government.

The decision below necessarily discriminates against taxpayers who have in similar circumstances made a settlement with the Federal Government as opposed to taxpayers who have made such settlements with State and local authorities. The Court disallowed petitioner's tax deduction because its allowance was equivalent to "directly recouping money paid in settlement." 299 F.2d at 844

The authorities cited as denying direct recovery all deal with attempts to reopen a settlement as between the original parties. This reasoning could not apply to payments made in settlements with State or local governments, for a federal tax deduction on account of such payments would not directly or indirectly disturb the sum received by the authority to whom it was paid. If the settlement here had involved a State statute, the deduction could not have been disallowed. Similarly, the rule stated below would not apply in

the case of a State income tax deduction for a payment to the Federal Government.

Considered in the light of this absurd discrimination, it is apparent that the court below has allowed the dual identities of the Federal Government as tax collector and as administrator of federal regulatory statutes to merge and become confused. Heretofore the policies of the income tax laws and of the regulatory statutes have been considered separately, without reference to the fact that the Government is the administrator of both. To carry out the intent of Congress as interpreted by this Court, it is important to preserve the rule that deductibility depends upon frustration of the policy of the statute which precipitated the payment. The fact that a given payment was made pursuant to compromise rather than judgment or was made to federal rather than State or local authorities should be immaterial in determining deductibility.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 335—October Term, 1957.

(Argued June 11, 1958 Decided September 29, 1958.)

Docket No. 24931

A. D. JUILLIARD & CO., INC., *Plaintiff-Appellant*,

v.

JAMES W. JOHNSON, Collector of Internal Revenue for the Third District of New York, *Defendant-Appellee*.

Before:

HINCKS and WATERMAN, *Circuit Judges* and
RYAN, *District Judge*.

Appeal by plaintiff from a judgment of the United States District Court for the Southern District of New York, dismissing the complaint after trial before Leibell, *J.* without a jury, *Affirmed*.

PAUL W. WILLIAMS, United States Attorney, Southern District of New York (John S. Clark, Myra Schubin, Assistant U. S. Attorneys, of counsel), *for Appellee*.

STROOCK & STROOCK & LAVAN, New York City, and Steptoe & Johnson, Washington, D. C. (Stephen Ailes and William C. Hill, Washington, D. C. and Martin D. Eile, New York City, of counsel), *for Appellant*.

RYAN, *District Judge*:

Juilliard & Co., appellant taxpayer, filed suit in the District Court seeking a refund of excess profits taxes assessed

and paid by it for the calendar year 1943 (Sec. 3772, Title 26 USC and Sec. 1340, Title 28 USC). Judge Leibell after trial without a jury gave judgment dismissing the complaint upon the merits.

Judge Leibell, as has been his custom, filed carefully prepared full and complete findings of fact and conclusions of law; he also filed a separate opinion. He has by his industry and scholarly thoroughness lightened the burden of this court; familiarity with his decision is assumed.

The suit raised the right of the appellant to deduct in its 1943 excess profits return two items, $410,219.31 and $4,184.63 as ordinary and necessary business expenses (Sec. 23(a)(1)(A), IRC 1939). Both sums represent the amounts paid to the Administrator of the Office of Price Administration by the appellant in compromise and settlement of civil treble damages alleged to have been incurred for overpricing on sales made by Juilliard in violation of Maximum Price Regulation 163, promulgated under Emergency Price Control Act of 1942 (56 Stat. 23, 50 USC App. Sec. 901 *et seq.*). The Commissioner of Internal Revenue refused to allow these payments or any part of them as ordinary and necessary business expense deductions. Judge Leibell denied any refund of taxes paid after computation based on such disallowance. We hold the result reached by the judge to be correct and affirm.

The OPA issued General Maximum Price Regulation, effective April 26, 1942, freezing all prices in the economy at the March, 1942 level. Thereafter, on June 16, 1942, the OPA issued effective June 22, 1942 MPR 163 which established ceiling prices on woolen and worsted civilian apparel fabrics for manufacturers.

Juilliard & Co. had long been a large manufacturer of women's woolen and worsted apparel fabrics. It also sold rayon, silk and cotton fabrics but fifty percent of its total sales of $52,091,804. in 1942 was of woolen and worsted

goods. Its mercantile operations were subject to the provisions of the Act and the regulations promulgated.

MPR 163 set up and defined three classifications of fabrics—"continuous" fabrics, embracing fabrics previously manufactured; "comparable" fabrics being fabrics of the same weave and containing substantially the same number of ends and picks per finished inch, the same yarn sizes, the same weight per yard, width and finish, and belonging to the same classification as a fabric sold by the manufacturer during the applicable base period, but manufactured from different blends of raw material; and "new" fabrics consisting of those which could not be classified as "comparable" or "continuous."

Juilliard on July 17, 1942 filed with the OPA its first ceiling price reports as required by MPR 163, for the period from June 22 to September 8, 1942. The reports covered thirty-eight fabrics all priced as "comparable" fabrics. The Juilliard method of pricing was difficult to understand as the raw material content was not indicated and of this the OPA advised it by letter of September 12, 1942. Official report forms had not been devised and most of the reports received by the OPA were unsatisfactory to it. The OPA concluded that this situation was due to the fact that the MPR 163 test for "comparable" fabrics afforded the manufacturer too wide a latitude. Amendment 4 of MPR 163 was published on September 2, 1942 (effective September 8, 1942) and this specified maximum tolerances by which a "subject" fabric could vary from a "base period" fabric in elements of construction. The amendment also set up a fourth classification—"similar" fabrics to include those fabrics which were similar in use, serviceability and appearance to a base fabric and yet could not fit within the category of "comparable" fabrics. Amendment 4 of MPR 163 continued in effect the provisions for relief where ceiling prices were not fair or equitable, but Juilliard at no time petitioned for a price adjustment on

the basis of hardship. The trial judge has found that Juilliard relied on its own interpretation of the regulation and amendment and sought to avoid using the pricing formula for a "new" fabric.

About September 20, 1942, the OPA had complaints from consumers about Juilliard's prices particularly on fabric style number A2391 which was the Juilliard lead fabric. It had been reported by appellant as "comparable" to the base period fabric W4512. By letter dated October 8, 1942 the OPA advised Juilliard that no refiling of the report of July 17, 1942 having been made on the standard forms supplied by the OPA after the September 8, 1942 Amendment 4, it had on analysis of the Juilliard reports as filed found that thirty-two of the thirty-eight fabrics reported on July 17, for the first period (June 22, to September 8, 1942) were not "comparable" and directed Juilliard to make refunds to its customers of excess charges. On October 19, 1942 Juilliard submitted reports on forty-seven fabrics under Amendment 4; thirty-five used "similar" and twelve "comparable" fabrics in computing the ceiling price. The trial judge found that of the thirty-five "similar" fabrics reported, twenty-nine exceeded the permissible tolerances and of the twelve "comparable" fabrics four exceeded the permissible tolerances. At a conference in Washington on October 22, 1942, the OPA advised Juilliard that no variations from the tolerances would be permitted and that the reports filed would have to be corrected and refiled. Following this, the OPA by letter dated November 6, 1942 notified Juilliard fabric by fabric that the ceiling prices of thirty-three fabrics (filed October 19, 1942) did not conform to the Regulation and that Juilliard would have to file new reports for both periods (under original MPR 163 and under Amendment 4), to which Juilliard replied by letter dated November 12, 1942 that the matter would be attended to by a Juilliard official on November 23, 1942 upon his return from a business trip. The OPA deter-

mined to institute a civil enforcement suit for injunctive relief and statutory damages.

A complaint was filed on November 19, 1942 in the United States District Court for the Southern District of New York. It alleged three separate counts: Counts I and III prayed for injunctive relief, Count II sought to recover a money judgment under Section 205(e) of the Act for the violations alleged. The trial judge has found that under a strictly literal application of the Regulation Juilliard would have been liable for $391,249.29 in overcharges on the fabrics listed on a schedule annexed to the complaint. When trebled the overcharges would have amounted to $1,173,747.87.

With the filing of the complaint the OPA obtained from the District Court an order citing appellant to show cause why an injunction *pendente lite* should not issue and it temporarily restrained appellant from selling twenty-seven specified styles of woolen and worsted goods, until new reports on ceiling prices had been submitted to the OPA and approved. It also prevented Juilliard from receiving payment from its customers for merchandise previously delivered until new ceiling prices could be determined. This resulted in holding up collection of over $300,000 of Juilliard's outstanding accounts; Juilliard later was permittted to receive and deposit in a separate fund the amounts due from customers to whom it had made sales of these specified fabrics. The suit was settled and compromised by stipulation of January 29, 1943 under which appellant paid to the Treasurer of the United States $410,219.31—three times the overcharges as calculated in compromise by the parties at the time of the settlement. It is important to note that this stipulation of settlement provided *in haec verba* "defendant agrees to pay to the Treasurer of the United States the sum of $410,219.31 in full settlement and compromise of any and all claims of the plaintiff arising out of the facts specified in Count II

of the complaint." As part of the settlement a consent judgment was entered on February 1, 1943 granting only injunctive relief against appellant; the stipulated amount of treble damages having been previously paid no money judgment was entered—although this payment was mentioned and referred to in the preamble of the judgment.

The payment of $410,219.31 under the settlement is one of the two payments which Juilliard sought to deduct on its 1943 excess profits tax returns as an ordinary and necessary business expense.

At trial Juilliard contended that it was so harassed, and its business so jeopardized by administratively inspired publicity and news releases that it was forced to settle and pay damages under duress. The trial court has held that in calculating the overcharges the OPA was considerate and that Juilliard had violated the Regulation in fixing the ceiling prices on most of its woolen and worsted fabrics for women's wear, especially on its best sellers and that whatever "duress" resulted from the OPA suit had its origin in appellant's violation of MPR 163 and was a direct consequence of the application of the legal sanctions provided by Section 205(a) and (e) of the Emergency Price Control Act. He also concluded that appellant's many violations in 1942 of the regulation were the result of negligence and its failure to take practicable precautions against the occurrence of the violations, and that the payment made by appellant of $410,219.31 in settlement was its free and voluntary act, after negotiations in which it had been represented by able counsel. There is ample in the record to sustain the trial judge's findings supporting these conclusions.

The discussions were initiated by Juilliard counsel; the settlement was reached after negotiations which extended over two months. At that time the OPA had no policy of settling treble damage suits for less than three times the amount of overcharges. It was prior to the passage

of the Chandler amendment of June 30, 1944 (58 Stat. 632-40), and the courts had no alternative but to impose treble damages; lack of wilfulness or inadvertence was no defense to a violation of the regulations. *Bowles* v. *American Stores*, 139 F. 2d 377; c. d. 322 U. S. 730; *Bowles* v. *Indianapolis*, 150 F. 2d 597.

The violations alleged were segregated into two periods —June 22, 1942 (the effective date of MPR 163) to September 8, 1942 (when Amendment 4 became effective), and from September 8, 1942 to November 21, 1942. Calculated upon a literal reading of the Regulation single damages for the first period amounted to $121,171.70 and for the second period to $270,077.59. As part of the settlement the OPA waived entirely any claim for damages for the first period.

The problem of the markup for allowable margin over and above manufacturing costs was also the subject of compromise. With the Juilliard operations the allowable markup presented more than the usual problems. It manufactured woolen and worsted fabrics in two mills—at Providence and at Stottville. Because of a strike at the Providence mill in 1941 the profit of that plant for that year had been practically nil; the Stottville plant had shown about 20%. The regulations provided for the taking of a company-wide markup on "new" fabrics and this resulted in an applicable markup for Juilliard "new" fabrics of 9.8%. Juilliard urged that under this markup of 9.8% it would not operate profitably. The damages which the OPA sought had been reached by computing the overcharges as the difference between the prices charged by Juilliard and the ceiling price calculated on a "new" fabric basis in accordance with regulations. The settlement figure was arrived at by allowing Juilliard to use the Stottville markup in calculating the ceiling price on a "new" fabric basis, and this reduced the overcharges for the second period in suit from $270,077.59 to $136,739.77. This concession however was not extended by the OPA so

as to make the Stottville markup applicable to the fixing of any of the 1943 allowable ceiling prices for "new" fabrics. The stipulation made as part of the settlement fixing the 1943 allowable ceiling prices for the violation fabrics applied the company-wide markup and not the Stottville 20% markup. Thus, for purposes of settlement of the OPA civil action only, the parties calculated the violation overcharges only in the following amounts—

Fabric	*Single*	*Treble*
A2391	$110,098.30	$330,294.90
W4648	7,258.20	21,774.60
W4649	17,450.58	52,351.74
Other	1,932.69	5,798.07
	$136,739.77	$410,219.31

After the payment of $410,219.31 in settlement Juilliard by checking and audit discovered that it had collected on other sales ceiling price overcharges in the amount of $30,009.24 for the period of August 1, 1942 to October 28, 1943, and made undercharges of $27,630.50 for the period from April 1, 1943 to October 28, 1943. Juilliard made a voluntary disclosure of this to the OPA by letter of October 28, 1943. In settlement the OPA credited appellant with the reported overcharges made prior to August 1, 1942 (for which no damages were recoverable under Sec. 205(e)) and permitted it to deduct the amount of undercharges. The OPA agreed to and did accept on February 2, 1944 an offer of settlement set forth in a letter from Juilliard of January 21, 1944 forwarding its certified check for $4,184.63 "in full payment of net maximum price overcharges for the period from June 22, 1942 to January 21, 1944."

The payment of $4,184.63 thus made is the second item which appellant sought to deduct on its 1943 return as an ordinary and necessary business expense. The trial judge has found that the overcharges involved in the net figure of

$4,184.63 were at least the result of Juilliard's failure to take practicable precautions to comply with MPR 163.

After the settlement and compromise of the civil suit, appellant found fabric A2313, a prior fabric, to be "similar" to fabric A2391 (which in the settlement discussions had been regarded as a "new" fabric). It applied to the OPA for approval to set up A2313 as a base fabric for calculation of the ceiling price of A2391. The OPA gave its consent and Juilliard was thereafter permitted to figure a new ceiling price for fabric A2391 which it will be recalled was a Juilliard lead fabric. We have heretofore noted that as part of the settlement of the suit, a stipulation (the third) was made under date of January 29, 1943; to this stipulation was annexed as Exhibit 1 a schedule of agreed maximum prices for a list of Juilliard fabrics. Included in this schedule was fabric A2391 with a maximum ceiling price of $2.825 per yard. It appears that priced as a fabric "similar" to A2313 the allowable ceiling price for A2391 would be $2.975, with an increased ceiling price differential of $.15 a yard. At trial and now on appeal Juilliard urges that it should be in any event tax credited with this difference as an overpayment on the settlement of $.15 per yard of A2391 sold amounting to a total of $44,074.54 which trebled would be $132,223.62. It contends that of the $410,219.31 paid in settlement, the sum of $132,223.62 was paid under a mistake of fact and on transactions for which it was not liable in damages in any amount, since as to these there had been no violation.

We find in the trial judge's decision and opinion specific factual findings more than sufficient to support his conclusion that "Juilliard's mistakes were so many and so basically wrong, that they were due, at least, to Juilliard's negligence and to its failure to take proper precautions to avoid violating the provisions of MPR 163." The conclusions reached were not premised on an erroneous holding, as appellant maintains, that an OPA treble damage payment is

ipso facto not deductible. It was noted by the trial judge that,

> "The consent judgment and settlement of the OPA action is not considered by this court as showing that the Juilliard Company either wilfully caused the overcharges to be made, or that they were the result of negligence or of Juilliard's failure to take 'practicable precautions' to avoid violating MPR 163."

The trial judge was not forgetful of *Jerry Rossman* v. *Commissioner*, 175 F. 2d 711 (2d Cir.) or of *George Schaefer & Sons* v. *Commissioner*, 209 F. 2d 440 (2d Cir.). The burden of establishing that the violations (which were clearly proved) were not the result of failure to take proper precautions was properly placed on plaintiff-appellant. *American Brewery* v. *United States*, 223 F. 2d 43 (4th Cir.). This burden the record shows it failed to carry.

This appeal in final analysis presents for us two questions: (1) does the trial record contain evidence to support the findings that the Juilliard violations were the result of a failure to take practical precautions and (2) should a re-examination of the amounts paid by Juilliard after compromise as damages for such violations if found, now be made to determine whether payment, in whole or in part, was made when not legally due or under a mistake of fact?

That Juilliard committed many violations is beyond question; there is sufficient evidence to convince us that these were more than inadvertent. The findings that appellant failed to take practicable precautions are supported by the evidence.

After Juilliard discovered that fabric A2391 could properly be classified for ceiling price calculation as "similar" to fabric A2313 in its 1941 line, it neither judicially nor administratively made application to reopen the settlement it had made to attempt to recoup the $132,223.62 it now

claims was solely attributable to excess payments as treble damages on fabric A2391. To have done so would have subjected all the violations alleged to re-examination and the possible insistence by the OPA (or at least the opportunity to insist) upon payment of damages for the waived violations of the first period or the application of the company-wide markup instead of the more liberal Stottville markup in the computation of damages.

The short and complete answer to the argument of appellant with respect to this $132,223.62 lies in the fact that no part of the total sum of $410,219.31 paid in settlement of the civil suit can be said to have been paid for any specific violation. It was a payment made and received by the OPA in compromise of all the violations alleged. The stipulation of settlement recorded it was paid "in full settlement and compromise of any and all claims of the plaintiff arising out of the facts specified in Count II of the complaint." The fact that as part of the mechanics of the settlement administrative justification was found in adopting a formula for computing the total reached and paid did not change the result accomplished and intended—a lump sum payment in compromise of all the violations charged. That this was an arbitrary formula and not intended or understood by the parties to earmark and limit each figure shown as an overcharge to a specific fabric listed alongside is evident from the fact that the total addition of $410,219.31 settled violations for both periods (Count II all claims) and that only the second period is included in the calculations; that the total arrived at includes the reduction accomplished by the permitted Stottville markup although this is not revealed by the figures, and that an amount of $1,932.69, trebled to $5,798.07, is shown as an overcharge attributable to fabrics identified only as "other."

We do not agree with the learned trial judge that the settlement became an integral part of the judgment en-

tered and therefore conclusive and immune from collateral attack in this suit. The judgment granted only equitable and injunctive relief as prayed for in Counts I and III; it did not constitute an adjudication on the claims for damages asserted in Count II, for these had been already disposed of by the parties by separate stipulation and compromise on which no judgment was ever entered. Yet, we do hold that the appellant is precluded from now urging that the full amount of $410,219.31 was not actually paid for admitted violations of the Act, because it voluntarily settled on the basis of that sum.

It is conceded by Juilliard that insofar as it might seek to recover the sum of $132,223.62 from the OPA "that book is closed." It is nonetheless closed, in our opinion, when it seeks to recover indirectly part of that sum by way of a tax exemption, when in order to do so it must reopen for consideration the question of its liability to the Administrator at the time of the compromise. And, this would follow even if appellant paid this money for a supposed violation which if litigated would have been found non-existent and on which appellant would have been exonerated. A party by settlement may surrender rights that the law would have sustained, but that is no reason for disregarding the settlement. *Hennessy* v. *Bacon*, 137 U. S. 79; *Staten Island Ice & Cold* v. *United States*, 85 F. 2d 68 (2d Cir.). The settlement was entered into by appellant to make the best terms possible with the OPA; the "hope of gaining was balanced against the risk of losing. There was an exchange of equivalents irrevocable except for fraud, a settlement of a controversy presumably honest." *Yonkers Fur Dressing Co.* v. *Royal Ins. Co.*, 247 N. Y. 435; *Castell* v. *United States*, 98 F. 2d 88 (2d Cir.). Appellant, as a result enjoyed the benefit of a waiver of liability for violations committed in the first period and a reduction in the overcharges for the second period as a result of the application of the 20% markup. It would be unfair for it, after retaining these benefits to attempt to repudiate such

part of the settlement as fifteen years later it discovers was less favorable to it than was warranted by the facts or the law. *Backus* v. *United States*, 59 F. 2d 242, c.d. 288 U. S. 610.

There was a compromise and settlement which resulted in a discharge of the OPA's claim against appellant for past violations and of appellant's claim of no violation. The dispute between the parties was bona fide, the claim was unliquidated because there was a difference of opinion as to the standards to be used in computing maximum prices; it was resolved and became binding on both debtor and creditor. Secs. 1278 *et seq.*, Corbin on Contracts; see also *Hensel* v. *Cahill*, 116 A. 2d 99. The very motive for the settlement was the uncertainty of establishing specific overcharges on many of the items; the alleged mistake which appellant here urges, was an item in issue on the compromise, and may not now be used as a reason to dissect it. Corbin on Contracts, Sec. 1292. Furthermore, in view of the amount of damages pleaded in the complaint it is far from certain that had this item of $132,223.62 been discovered at that time the total sum appellant would have had to pay in full settlement of all and any violations would have been reduced by that much. The settlement was not animated by the assumed existence of that particular violation; it was incidental to the payment of an agreed sum of money for a multitude of violations and appellant's past conduct as a whole—and a sum which the trial court found to be more than reasonable under the circumstances. *Grimes* v. *Sanders*, 93 U. S. 55.

The "vital principle" behind the rule of law which prohibits appellant from re-examining the *quid pro quo* of the settlement is that,

> "he who by his language or conduct leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a

change of position is sternly forbidden. * * * There is no rule more necessary to enforce good faith than that which compels a person to abstain from asserting claims which he has induced others to suppose he would not rely on." *Backus* v. *United States, supra*, 257-58.

The effect of a compromise and settlement effected by parties competent to contract is that of a judgment which can only be set aside in a direct proceeding. *Oggleshy* v. *Attrell*, 105 U. S. 605, cf. *United States* v. *International Building Co.*, 345 U. S. 502.

We can see no distinction between seeking to reopen in this suit the compromised question of the amount of appellant's liability for the purpose of a tax deduction and seeking to reopen it for the purpose of directly recouping money paid in settlement, which appellant concedes it may not accomplish.

The bar which we conclude lies in appellant's path has nothing to do with collateral estoppel. Clearly that could not be the reason for the question of a violation of the maximum price for fabric A2391 was never litigated, never decided and no judgment ever entered. *Fruehauf Trailer Co.* v. *Gilmore*, 167 F. 2d 324; *Trapp* v. *United States*, 177 F. 2d 1; *United States* v. *International Building Co., supra*; *Commissioner* v. *Sunnen*, 333 U. S. 591. The reason lies in the manifest unfairness and disruption of settled rights which would result from permitting a party to a completely executed agreement to reopen the issue of his liability in order to obtain a collateral benefit from the very consideration surrendered.

The findings of the trial court were that the violations which Juilliard compromised were the result of neglect and failure to take practicable precautions. The nature and character of the violations were particularly considered and so found. The burden of showing that the violations were innocent and the result of inadvertent error was not sus-

trained by appellant. *American Brewery v. United States, supra.* Under *Jerry Rossman, supra,* and the latest authority from the Supreme Court in *Tank Truck Rentals v. CIR,* 356 U. S. 30 and *Hoover Express Co. v. United States,* 356 U. S. 38, allowance of these payments as a necessary and ordinary business expense would frustrate the policy of the statute and are consequently not recoverable by appellant.

The judgment of the district court is affirmed.

HINCKS, *Circuit Judge,* dissenting in part:

Of the $410,219.31 treble damage payment made by the appellant, I would hold that the sum of $132,223.62 was deductible as an ordinary and necessary business expense. In all other respects I agree with the disposition made by my brothers.

Judge Leibell's careful and complete findings establish clearly that in the negotiations which followed the filing of the OPA complaint a settlement formula had been tentatively agreed upon which took no account of overcharges on Juilliard's fabric No. A-2391; and that thereafter errors were discovered by Juilliard employees in the Juilliard report on its fabric No. A-2391 which were promptly reported to OPA. The resulting overcharges in No. A-2391 amounted to about $110,000 which OPA insisted be trebled and added to the tentative settlement. This item brought the total amount of the settlement up to $410,219.31. Thus the amount paid by Juilliard for the settlement clearly included the trebled overcharges on fabric A-2391 as Judge Leibell repeatedly stated in his opinion.

Three months after the settlement had been completed, the appellant reported to OPA a revised basis for the computation of a higher maximum price on A-2391. This was based largely on fabric No. A-2313 which later was

found by OPA to be a proper base period fabric to which A-2391 was similar. As a result, OPA allowed a ceiling price of $2.975 per yard for A-2391. Although the fact basis for this higher ceiling had been in existence and available at and prior to the settlement with OPA, it was not advanced by the appellant nor given effect by OPA until after the settlement. If the overcharge on A-2391 had been computed on the basis of this higher (by 15¢ per yard) ceiling which was subsequently allowed, the amount of the overcharges on A-2391 would have been $44,074.54 less and the trebled damages would have been $132,223.62 less than the amounts included in the settlement.

I fully agree with my brothers that the appellant, having entered into a settlement with OPA, may not now recover back any part of the amount paid. But that is not to say that it is not entitled to a tax deduction. The allowability of a tax deduction as a business expense of damages paid to OPA depends upon whether the overcharges were made inadvertently or under such circumstances that the allowance of a deduction therefor would not frustrate any sharply defined statutory policy. *Jerry Rossman Corp.* v. *Commissioner*, 2 Cir., 175 F. 2d 711; distinguished but not disapproved in *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U. S. 30.

In the circumstances of this case, the OPA's subsequent approval of the higher ceiling upon a basis which had existed before the settlement, serves as an authentic demonstration that the overcharges computed on the basis of the higher ceiling would have satisfied the statutory objectives. Consequently, the payments to the extent that they were based on the lower ceiling exceeded what was required to satisfy the statutory objective and a tax deduction in the amount of such excess ($132,223.62) would not frustrate national policy.

Judgment of the Court of Appeals

JUDGMENT

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-ninth day of September one thousand nine hundred and fifty-eight.

Present:

HON. CARROLL C. HINCKS,
HON. STERRY R. WATERMAN,
Circuit Judges.

HON. SYLVESTER J. RYAN,
District Judge.

A. D. JUILLIARD & COMPANY, INC., *Plaintiff-Appellant*

v.

JAMES W. JOHNSON, Collector Internal Revenue, Third District of New York, *Defendant-Appellee*

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed; with costs to the appellee.

A. DANIEL FUSARO
Clerk

Order Denying Rehearing

Filed and Entered October 31, 1958

(Style of Court and Title Omitted.)

The petition for rehearing is denied.

s/ STERRY R. WATERMAN
U.S.C.J.

s/ SYLVESTER J. RYAN
U.S.D.J.

Judge Hincks dissenting.

s/ CARROLL C. HINCKS
U.S.C.J.

October 31, 1958

A petition for rehearing having been filed herein by counsel for the appellant,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. DANIEL FUSARO
Clerk

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Office-Supreme Court, U.S.
FILED
FEB 26 1959
JAMES R. BROWNING, Clerk

No. 671

In the Supreme Court of the United States

OCTOBER TERM, 1958

A. D. JUILLIARD & CO., INC., PETITIONER

v.

JAMES W. JOHNSON, Collector of Internal Revenue for the Third District of New York

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 37a-60a)[1] is reported at 166 F. Supp. 577. The opinions of the Court of Appeals (Pet. 1a-16a) are reported at 259 F. 2d 837.

[1] Record references are to the Appendix to the taxpayer's brief in the Court of Appeals. Supplemental record references are to the Collector-Appellee's appendix in the Court of Appeals.

JURISDICTION

The judgment of the Court of Appeals was entered on September 29, 1958. (Pet. 17a.) A petition for rehearing was denied on October 31, 1958. (Pet. 18a.) The petition for a writ of certiorari was filed on January 28, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Whether, on the facts found, the courts below correctly held that taxpayer corporation, in computing its excess profits taxes for 1943, might not deduct as business expenses any part of the amount that it paid to the United States in settlement of its liability for violating Regulations of the Office of Price Administration.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

Emergency Price Control Act of 1942, c. 26, 56 Stat. 23:

SEC. 205. *Enforcement.*

* * * * *

(e) If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, the person who buys such commodity for use or consumption other than in the course of trade or business may bring an action either for $50 or for treble the amount by which the consideration exceeded the applicable maximum price, whichever is the greater, plus reasonable attorney's fees and costs as determined by the court. For the purposes of this section the payment or receipt of rent for defense-area housing accommodations shall be deemed the buying or selling of a commodity, as the case may be. If any person selling a commodity violates a regulation, order, or price schedule prescribing a maximum price or maximum prices, and the buyer is not entitled to bring suit or action under this subsection, the Administrator may bring such action under this subsection on behalf of the United States. * * *

* * * * *

(50 U.S.C. App. 1946 ed., Sec. 925.)

STATEMENT

The material facts as found by the District Court (R. 2a-33a, 60a) and the Court of Appeals (Pet. 1a-11a, 13a) may be summarized as follows:

This is an action for the recovery of excess profits taxes for 1943 instituted by the taxpayer corporation.

The suit raised the issue of taxpayer's right to deduct two items, $410,219.31 and $4,184.63,[2] as business expenses. Both of these sums were paid by taxpayer to the Office of Price Administration in compromise and settlement of a suit for treble damages for price violations brought by OPA against taxpayer in 1942. The OPA complaint rested upon a multitude of items, the aggregate amount of alleged overcharges being $391,249.29; treble damages on this total claim would have amounted to $1,173,747.87. (R. 2a, 3a; 18a-19a; Pet. 1a-2a, 5a.)

After the settlement was effectuated and payment of the $410,219.31 had been made in January 1943, taxpayer claimed that there was an error in the formula used to arrive at the settlement figure of $410,291.31. The alleged error was that a certain fabric known as A-2391 should have been treated as similar to another fabric (A-2313) rather than as a new fabric. Had A-2391 been regarded in this light, it would have carried, the argument runs, a different ceiling price, and the amount of overcharges attributable to this item would have been $66,023.76, rather than $110,098.30. The difference, when trebled, is $132,223.62. To this extent, taxpayer contends, the settlement was not accurately computed and taxpayer is entitled to a business-expense deduction. (R. 26a-29a; Pet. 9a.)

The stipulation of settlement provided that "this stipulation binds defendant for all purposes, and not merely for this action." The amount agreed upon

[2] No question as to the $4,184.63 is here involved.

($410,219.31) was paid "in full settlement and compromise of any and all claims of the plaintiff arising out of the facts specified in Count II of the complaint." (R. 28a; Pet. 11a; see also Exhibit 43.1, Supp. R. 27a.)

There was no mutual mistake of fact inducing the settlement and it was reached after extended negotiations. The violations of taxpayer covered by the settlement were due to taxpayer's negligence and its failure to take proper precautions. (R. 27a, 60a; Pet. 9a, 11a.)

Upon the basis of the entire record, both courts below concluded that it would frustrate the policy of the Emergency Price Control Act to allow any part of the $410,219.31 payment as a deduction for business expenses. Taxpayer's complaint and its claims for such deduction were accordingly dismissed (R. 54a, 60a; Pet. 15a).

ARGUMENT

Both courts below (including the dissenting judge in the Court of Appeals) were in full agreement that taxpayer might not deduct, as ordinary and necessary business expenses, payments made to the United States in settlement of charges that taxpayer had been guilty of willful or negligent violations of OPA ceiling price regulations. This, of course, is in full accord with the principles only recently elaborated by this Court in *Tank Truck Rentals* v. *Commissioner*, 356 U. S. 30, 36-37.[3] The only

[3] See also *Jerry Rossman Corp.* v. *Commissioner*, 175 F. 2d 711 (C.A. 2d); *National Brass Works* v. *Commissioner*,

point of disagreement in the Court of Appeals was as to whether, in the particular circumstances, the compromise settlement of the OPA charges could be dissected and whether it could be said that it rested in definite and ascertainable part upon a mistaken view of the extent of some of the violations. This involves an assessment of the parties' understanding, the course of the compromise negotiations, and the compromise agreement itself. It does not involve any question of general importance.

The majority below found "that no part of the total sum of $410,219.31 paid in settlement of the civil suit can be said to have been paid for any specific violation." (Pet. 11a.) It also found that the "very motive for the settlement was the uncertainty of establishing specific overcharges on many of the items." (Pet. 13a.) Finally, it found the evidence "more than sufficient" to sustain the District Court's holding that the violations were so many and so basic that they reflected, at the least, negligence and a failure to take proper precautions. (Pet. 9a.)

If, as found below, the settlement represented a lump settlement covering a multitude of violations, and determinate amounts cannot be attributed or assigned to individual charges, the result reached was the only possible one. Where a settlement is in gross, there is obviously no means of appraising the "give and take" on particular issues. Thus the sug-

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205 F. 2d 104 (C. A. 9th); *George Schaefer & Sons* v. *Commissioner*, 209 F. 2d 440 (C. A. 2d); Rev. Rul. 54-204, 1954-1 Cum. Bull. 49; and cf. *Milton S. Kronheim & Co.* v. *United States*, 163 F. Supp. 620 (C. Cls.).

gestion that taxpayer may have had defenses (or partial defenses) on some issues overlooks the fact that taxpayer, had it gone to trial on the violation charges, might have suffered a liability very substantially in excess of the amount of the settlement. On the findings below, it cannot be said that any portion of the settlement represents a sum paid under misapprehension or mistake. Rather, the settlement represents a liquidation of the entire liability for a congeries of acts and practices which were in contravention of federal law and policy. As such, it is, on settled principles, non-deductible.

CONCLUSION

The case presents no issue of general importance. There is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

A. D. JUILLIARD & CO., INC., *Petitioner*,

v.

JAMES W. JOHNSON, Collector of Internal Revenue for the Third District of New York, *Respondent*.

PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

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The Government's Position

As pointed out at page 6 of the Petition for Certiorari, the Court of Appeals in its opinion (Pet. 11a) asserts that the settlement in this case was a lump sum settlement, no part of which could "be said to have been paid for any specific violation." The presence of this statement in the opinion is advanced by the Brief in Opposition as a complete and adequate basis for the denial of certiorari in this case.

The Court of Appeals made no effort to state the legal effect of that assertion on the question of deductibility in this income tax case, although a serious legal

question is presented.[1] Instead, possibly in recognition of the absence of any factual basis in the record for such a finding, it passed directly to the broader proposition that inquiry here into the nature and purpose of the payment was barred solely because the settlement was made with the Federal Government. Brushing aside the District Court's erroneous holding that this particular settlement had taken on the character of a judicial act, the Court held:

> . . . that the appellant is precluded from now urging that the full amount of $410,219.31 was not actually paid for admitted violations of the Act, because it voluntarily settled on the basis of that sum.
>
> It is conceded by Juilliard that insofar as it might seek to recover the sum of $132,223.62 from the OPA "that book is closed." It is nonetheless closed in our opinion, when it seeks to recover indirectly part of that sum by way of a tax exemption, when in order to do so it must reopen for consideration the question of its liability to the Administrator at the time of the compromise. (Pet. 12a).

Because the test for deductibility thus employed (1) is in conflict with the holding of this Court in *Tank Truck Rentals, Inc.* v. *Commissioner*, 356 U. S. 30, (2) discourages compromises of litigation with the Federal Government, (3) conflicts with decisions in the First Circuit and the Court of Claims, and (4) improperly makes deductibility depend on whether

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[1] See Lustig v. United States, 138 F. Supp. 870 (1956), discussed at page 12 of the petition for certiorari, in which the Court of Claims holds that the circumstances of a lump sum settlement and the manner in which the amount was arrived at must be inquired into in order to determine deductibility of a part of the payment.

the compromise is with a State or the Federal Government, we sought certiorari.

Respondent's Brief in Opposition makes no effort whatsoever to defend this principal holding or to contest what we have stated the significance and effect of it to be. Instead, respondent is content to point to the lump sum settlement basis for the holding of the Court of Appeals. Nor does respondent attempt to support this alternative holding. It merely states that "*if*" it is true "the result reached is the only possible one." And this is a legal conclusion for which no authority is cited, no reason stated.

Respondent therefore does not attempt to support the propriety of the decision below on *either* ground. Its position thus may be paraphrased as follows: "Even though the Court of Appeals held, as petitioner contends, that a settlement of a Government claim may never be dissected to determine deductibility of a payment for tax purposes (a legal conclusion which we do not defend), it could have based its decision solely on its finding that this was a lump sum settlement (a factual conclusion which we also do not defend). Since the second holding involves no issue of general importance, certiorari should be denied."

Regardless of what it could or might have done, the fact is that the Court of Appeals did not base its holding on or limit its holding to the lump sum settlement point. Its decision, unless reversed, plainly stands as a precedent for the broader proposition, quoted above and extensively argued in the opinion, that no settlement of a Federal Government claim can be reopened to determine deductibility for income tax purposes, since a deduction would constitute an indirect recovery of money which could not be recovered di-

rectly. For certiorari purposes, the point made in respondent's brief must be the proposition that, on review, this Court would not reach the broad proposition for which this case stands.[2] Yet, even if the Court of Appeals had made this point an alternative basis for decision, nothing could be clearer than that this Court on review would find the record so completely devoid of support for this finding as to require the Court to pass directly to the main issue in this case. In fact, we strongly suspect that on review the Government would be no more disposed to defend, on the record, this finding than it was in its Brief in Opposition.

The Lump Sum Settlement Holding and the Record

It should be noted at the outset that the majority's finding, on which the Government now relies, in effect overrules the District Court and adopts a position never urged upon it by the Government, much less by petitioner. The finding cannot be reconciled with the view of the facts adopted by the District Court and advocated by the Government throughout.

There is no dispute over the manner in which the settlement was reached by the parties. Contemporaneous memoranda prepared by counsel handling the negotiations for each side were placed in the record, and petitioner's counsel testified concerning these events at the trial. There was no dispute between the

[2] We recognize that the Court will deny certiorari in a case involving a point worthy of certiorari if it is apparent that the case on review would be decided on other grounds and that the certiorari question would not be reached. Stern & Gressman, Supreme Court Practice, 2nd Edition (1954), p. 112.

parties over these events and the trial judge made specific and clear findings with respect to them.

The nature of the settlement as it emerges from the trial court's findings, all amply supported, in fact uncontroverted, on the record, is as follows:

First, the Government contended and the trial judge found (Finding 31, R. 19a-21a)[3] and relied upon the fact (Opinion, R. 39a, 40a) that this was a treble damage settlement. This can only mean that the amount paid constituted a trebling of all overcharges for which OPA wished to hold petitioner responsible. That a treble damage settlement is the very antithesis of a lump sum settlement was emphasized by the Government's counsel at trial when, in cross-examining the attorney who had represented petitioner at settlement, he stated the Government's then position:

> Q. As a matter of fact, a settlement was negotiated on the basis of trebling something and not on a lump sum basis?
>
> A. That is right, it was on the basis of trebling some $136,000, and they came up with a figure of $410,219. (R. 192a)

Second, it is clear that a settlement formula was agreed upon by the parties without regard to the ultimate figure to be reached. As stated by the Trial Judge in the course of his Finding 29:

> Recognizing the vagueness of the original Regulation, MPR 163, which went into effect June 22, 1942, the obviously low markup which Juilliard received under the "new" fabric formula appli-

[3] Page references in this reply, designated "R", refer to the Appendix to Appellant's Brief before the Court of Appeals, filed with the Petition for Certiorari.

cable to it under the Regulation, adjustments were tentatively agreed upon by OPA and Juilliard counsel. The whole period under MPR 163 prior to Amendment 4 was eliminated from consideration and the company-wide profit ratio, used in the "new" fabric formula, was increased by Juilliard to use the Stottville markeup (about 20%) instead of the company-wide markup (about 9.8%), so as to eliminate the adverse effect of the 1941 strike at the Providence mill. *As the result of this tentative agreement, the overcharges would have been $26,000, trebled to $78,000. Fabric A-2391 was not included.* (Emphasis added). (R. 19a).

Third, it is clear that, *after* this tentative agreement was reached, an error in computing the costs on fabric A-2391 was discovered, and that overcharges equal to $110,049.48 were *added* to the $26,000 figure, making single damages of approximately $136,000 and bringing the trebled total from approximately $78,000 to the figure of $410,219.31 which petitioner paid. (Finding 30, R. 19a).

Thus it is clear, as the Trial Court held and as the Government has contended up to now, that the amount paid was intended by the parties to be related to specific violations. Purely as a matter of chronology, there can be no doubt that the overcharges on fabric A-2391 are directly responsible for a specific portion of the amount paid in settlement. The mistake in computing this amount is accordingly directly responsible for a specific portion of the settlement. Judge Hincks, in dissent, convincingly demonstrated the truth of this proposition. (Pet. 15a)

On the record of this case, the holding by the majority of the Court of Appeals that no part of the total

sum of $410,219.31 paid in settlement of this civil suit can be said to have been paid for any specific violation cannot be explained, much less justified. The contention, quoted in part in the Brief in Opposition, that "the very motive for the settlement was the uncertainty of establishing specific overcharges on many of the items;" ignores the fact that the record contains no reference to any negotiation concerning the individual ceiling price of any item. The remainder of that sentence, "the alleged mistake which appellant here urges, was an item in issue on the compromise, and may not now be used as a reason to dissect it," (Pet. 13a) can never be reconciled with the admitted fact that the mistake in question was discovered some months after the settlement was completed and the money paid (Finding 38, R. 26a).[4]

We submit that the lump sum holding, if that it is, would never prevent this Court from reaching the main legal question in this case. Indeed, if it were the only basis for the decision below, this Court might well wish to consider whether or not that question itself should not be reviewed on certiorari because in ignoring the factual determinations of the Trial Court and in making these completely unsupportable findings, the Court of Appeals "has so far departed from the

[4] It cannot be argued that petitioner *agreed* to give up the right to dissect this settlement at a later date. Although the Brief in Opposition states (page 4) that the settlement stipulation provided that it was binding "for all purposes, and not merely for this action," this statement is incorrect. As was pointed out below when the Government made this contention, the quotation is taken from another stipulation (filed with the Government's brief below at page 27a) which set the maximum prices to be employed by petitioner for future sales and which had nothing whatsoever to do with the money damage settlement.

accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's power of supervision." (Rule 19, Revised Rules of the Supreme Court)

Conclusion

We submit that the case for certiorari stated in the petition stands unchallenged. The Brief in Opposition does not seek to meet it. It merely urges the untenable proposition that certiorari in this case should not be granted because there is an alternative, albeit unsupportable, basis for the decision below.

Respectfully submitted,

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